The Effect of Outsourcing on Remaining Workers, Rent Distribution, and Inequality

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Abstract

Firms can decide whether to produce some goods and services in-house or purchase them from the market. They are increasingly purchasing from the market—using subcontractors, temp agencies, and other outsourced labor. Low-wage workers' wages decline when they are outsourced. Workers who remain after an outsourcing event are also affected by it because outsourcing changes the internal structure of the firm. However, little is known about how remainers are affected. I analyze the impact of occupational layoff (OL) outsourcing on remainers using matched employer-employee data based on German social security records. OL outsourcing increases remaining workers' earnings by 5% in a sample of 249 outsourcing events. Remainers are also more likely to stay at the outsourcing firm in the long-term. These results are consistent with the theory that firms reallocated rents to the remainers. Additionally, outsourcing firms are largely unionized, and the earnings gains are slightly larger among low-wage remainers, suggesting unionization plays a role in which workers receive higher earnings. Finally, I analyze the impact of OL outsourcing on inequality. OL outsourcing reduces within-firm inequality as the lowest-wage workers leave. Using Recentered Influence Functions, I show that a 1% increase in the share of workers in an OL outsourcing event increases earnings at the top of the distribution by approximately 10%, and aggregate inequality increases as well. The effect on the top of the wage distribution suggests prior estimates underestimate the impact of outsourcing on wage inequality by not accounting for increased wages among high-wage remaining workers.

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